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UNCLAS SECTION 01 OF 02 BRASILIA 001608

SIPDIS

SENSITIVE

STATE PLEASE PASS TO USTR
NSC FOR BREIER
DEPT OF TREASURY FOR FPARODI
USDOC FOR 3000/JOHN TOCCO
USDOC FOR 3134/USFCS/OIO/WH/EOLSON
USDOC FOR 4332/ITA/MAC/WH/OLAC/MWARD
USDOC FOR 6950/Dean Woddard - Aerospace
DOT FOR SUSAN MCDERMOTT, CAROLYN COLDREN
FAA MIAMI FOR MARK RIOS

E.O. 12958: N/A

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SUBJECT: VARIG BOARD STRUGGLES TO SAVE AIRLINE

REF: BRASILIA 1566

1. (SBU) Summary and Introduction. In a June 14 meeting with the Ambassador, key members of the VARIG board outlined the predicament in which the airline finds itself. ILFC (International Leasing Finance Corporation), a subsidiary of of AIG and a key aircraft leasing company, has indicated that it intends to start repossessing the 11 planes that it has leased to VARIG, beginning on June 17. And while, at least according to our VARIG interlocutors, the GOB has agreed to drop its appeals of the airline's US\$1.1 billion judgment against the government, it will still take several weeks for this money to be disbursed. In the meantime, ILFC is playing hardball and has reportedly stated that it plans to take back its aircraft even if VARIG pays its debt arrearages. Airline officials worry that the rescue package they have been so carefully constructing will begin to unravel once ILFC repossesses, as the other leasing companies might follow suit and the GOB might then backtrack on its commitment to ensuring the company's survival. End Summary and Introduction.

2. (U) On the morning of June 14, VARIG Chairman Henrique Neves telephoned the Ambassador to request a meeting that same day. Scheduled for that afternoon, key members of the VARIG board (including President David Zylbersztajn and Vice-President Omar Carneiro da Cunha) recounted to the Ambassador the airline's plight. Michael Conolly, Executive Vice-President for TAP (Air Portugal) - VARIG's potential foreign investor- accompanied the VARIG delegation. Econ Counselor, Commercial Service Deputy Senior Commercial Officer, and SpecAsst sat in as well.

3. (U) During the conversation, Zylbersztajn and Carneiro da Cunha made the following points.

-- President Lula had directed that the GOB cabinet and staff find a way to allow the government to quickly inject capital into VARIG. While rescheduling debt, particularly with INFRAERO (the GOB's airport authority), might take as long as six months, within "a few weeks" the GOB would be able to free up the US\$1.1 billion due VARIG in the airline's court case against the government.

-- All the major aircraft leasing companies were on board with the VARIG restructuring plan (Reftel) except for ILFC. (Per post's contacts, the accuracy of this statement is open to question.) Sensing that it could place its aircraft with better customers, ILFC had taken the tack that it would take back its planes regardless of whether VARIG paid its debt or not. (Apparently, ILFC's two Boeing 777s are headed to Continental while the Brazilian cut-rate airline GOL would take its 737-700s.)

-- Just this week, VARIG had resumed payments to all its leasing companies planned to at least keep up with current payments.

-- If ILFC repossessed its planes - and VARIG planned to return them at a rate of one per week - the other leasing companies might follow suit. The GOB might then rethink its commitment to the airline, reasoning that there is no point in releasing a billion dollars to a company that will soon collapse anyway. Board members worried that the lack of a financing bridge between June 17 (ILFC's deadline) and the expected two to three week period it would take for the lawsuit revenues to arrive might be fatal.

4. (U) Ambassador acknowledged that the new VARIG board had made valiant efforts to free the carrier from its debt nightmare. However, he stated, time was not on the company's side and if the airline was to survive the U.S. leasing companies would, at a minimum, need to receive

payment quickly for as much of their receivables as possible. Carneiro da Cunha noted that GOB Vice-President Alencar had already sent a letter to ILFC, although, he admitted, that correspondence did not contain detailed assurances. VARIG board members agreed that it is essential for VARIG to make known to the leasing companies the GOB's commitment to saving VARIG.

15. (SBU) Comment. Judging from the body language of our interlocutors, VARIG's situation is indeed grim. While Lula may have indeed directed that his staff work to rescue the carrier, getting all the agencies/interests within the government to quickly work toward this goal will be a stiff challenge, especially given the legal constraints outlined in reftel and the ongoing preoccupation of key policymakers with ongoing corruption scandals. Post will continue to monitor developments regarding this issue as the June 17 deadline approaches.

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